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No New Tax Cuts

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With a war in Iraq and looming post-war costs, growing pressures for a prescription drug benefit, increased expenses for domestic security and a ballooning budget deficit, Congress must exercise restraint on both revenues and spending to prevent fiscal policy from spiraling out of control. The consensus in favor of long-term budget balance must be re-established. This issue is now directly before Congress as it debates the federal budget.

The fiscal outlook is much worse than official projections indicate. These projections assume that the tax cuts enacted in 2001 will expire at the end of 2010. They also assume that discretionary spending, the part of the budget that pays for national defense, domestic security, education and transportation, will shrink continuously as a share of the economy. Neither of these assumptions is realistic.

Moreover, the official projections do not include the costs of war and reconstruction in Iraq. And they ignore the inevitable need to reform the alternative minimum tax, which is not indexed for inflation and will apply to some 40 million households within 10 years — up from two million today.

Under more realistic assumptions, the deficit projections are cause for alarm. A recent study by Goldman Sachs includes this forecast: if the president's proposed new tax cuts are enacted, a Medicare prescription drug benefit is approved, the A.M.T. is adjusted and appropriations grow modestly, the deficits over the next 10 years will total $4.2 trillion — even if the Social Security surplus is included. If it is not included, the deficit would be $6.7 trillion. Under these circumstances, the ratio of publicly held debt to gross domestic product climbs within 10 years to nearly 50 percent, from 33 percent just two years ago.

And all of this happens before the fiscal going gets tough. Looming at the end of the decade is a demographic transformation that threatens to swamp the budget and the economy with unfunded benefit promises, like Social Security and Medicare, of roughly $25 trillion in present value. Our children and grandchildren already face unthinkable payroll tax burdens that could go as high as 33 percent to pay for these promised benefits. It is neither fiscally nor morally responsible to give ourselves tax cuts and leave future generations with an even higher tax burden.

Will Congress stand up for fiscal responsibility?

And yet tax cuts are the primary focus of this year's budget debate. To speed enactment of tax cuts, Congress is planning to use a special fast-track procedure called "reconciliation" in the budget resolution. While determining the size of the tax cut to be given fast-track protection in the budget is sometimes dismissed as a procedural matter, it is not: whatever its size, a tax cut that receives this protection is almost certain to be enacted in the later tax legislation. Members of Congress should not therefore approach the budget decision with the idea that a tax cut given such status now can be easily scaled back later.

The president has proposed a cut of $726 billion, which the House has already approved. The Senate has reduced the cut to $350 billion.

Given the rapidly deteriorating long-term fiscal outlook, neither proposal is fiscally responsible. It is illogical to begin the journey back toward balanced budgets by enacting a tax cut that will only make the long-term outlook worse. Furthermore, the proposed tax cuts are not useful for short-term fiscal stimulus, since only a small portion would take effect this year. Nor would they spur long-term economic growth. In fact, tax cuts financed by perpetual deficits will eventually slow the economy.

The tax cuts now before Congress do not pay for themselves. No plausible array of matching spending cuts or offsetting revenue increases has been, or will be, proposed to close the gap resulting from a large new tax cut.

We believe that there should be no new tax cuts beyond those that are likely to provide immediate fiscal stimulus, and that avoid growing revenue loss over time. If, however, Congress decides it must approve a tax cut, it should pass the Senate's. While a $350 billion tax cut does not fit our definition of fiscal responsibility, it comes closer than a tax cut of $726 billion. Moreover, Congress should reestablish the pay-as-you-go rule in which tax cuts and entitlement expansions must be offset. The discipline of this rule greatly contributed to the elimination of budget deficits in the 1990's and is clearly needed again.

Congress cannot simply conclude that deficits don't matter. Over the long term, deficits matter a great deal. They lower future economic growth by reducing the level of national savings that can be devoted to productive investments. They raise interest rates higher than they would be otherwise. They raise interest payments on the national debt. They reduce the fiscal flexibility to deal with unexpected developments. If we forget these economic consequences, we risk creating an insupportable tax burden for the next generation. □

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